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Case of Preference Bondholders,

of

Grand Trunk Railway.

1861.

GRAND TRUNK RAILWAY OF CANADA.

CASE

OF

THE PREFERENCE BONDHOLDERS,

AND ITS BEARINGS ON THE

POSITION AND RIGHTS OF THE OTHER CLASSES INTERESTED IN THE RAILWAY.

LONDON:
PETTER AND GALPIN, LA BELLE SAUVAGE YARD,
LUDGATE HILL, E.C.

1861.

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PETTER AND GALPIN, BELLE SAUVAGE PRINTING WORKS, LUDGATE HILL. E C.

GRAND TRUNK RAILWAY COMPANY OF CANADA.

So much misconception prevails as to the rights of the Preference Bondholders, and as to the effect of the exercise of those rights on the general interests of the Railway, that it is deemed desirable, for the information of all classes interested, to give an outline of the case, and of the course intended to be pursued in asserting the rights of the Preference Bondholders, as first incumbrancers, against the claim set up by judgment creditors to seize the rolling stock and plant.

Prior to the year 1856 the province of Canada had advanced to this Railway £3,111,500; for which it had, by the several Acts constituting the Company, a first lien or charge on the Railway and property of the Company.

In 1856 the Company, being unable to raise the further capital required to proceed with the works, applied to the Government of Canada for aid; and as the result of negotiation between the Company and the Government the Relief Act of 1856 was passed, under which the First Preference Bonds were issued.

That Act provides as follows:—

"For the purpose of enabling the Grand Trunk Railway Company of Canada to complete their undertaking, the

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Governor in Council shall be and is hereby authorised to carry into effect the arrangement provisionally entered into between the Government of Canada and the said Company, based upon the following terms, viz. :—

"The said Company shall be authorised to issue preferential bonds to the extent of Two Millions of Pounds sterling. The holders of such bonds to have priority of claim therefor over the present first lien of the province.

"The proceeds of the said bonds shall be deposited with the provincial agents in London, and released to the Company on the certificates of the Receiver General, upon proof, to the satisfaction of the Governor in Council, of progress of the several works hereinafter mentioned."

Shortly after the passing of this Act, subscriptions were solicited towards the first Preference Bonds in a circular signed by the Secretary of the Company, and dated the 9th of December, 1856, in which it was stated that "the holders of such Bonds are to have a *priority of claim over the present first lien of the province.*" In the same circular, the Act of 1856 was described as a *concession by the Government of "the first charge on the undertaking, amounting to upwards of three millions sterling.*" The last paragraph of the circular is in these words :—"It has been before mentioned *that these Debentures are to have priority of claim over the present first lien of the province, and* THERE CANNOT, THEREFORE, BE ANY DOUBT AS TO THEIR SECURITY AND VALUE AS AN INVESTMENT."

In 1858, a further Relief Act was passed, under which the Second Preference Bonds were issued for £1,111,500, being the balance of the Province's lien beyond the two millions First Preference Bonds.

In a circular, dated 3rd March, 1859, signed *by all the London Directors*, and soliciting subscriptions for the Second Preference Bonds, the following statement appears :—"The sum of

£3,111,500 has been raised on Bonds of the Province of Canada, the interest on which formed *the first claim on the Railroad.*" In the same circular the Directors state that "the proposed new issue of £1,111,500 Second Preference Debentures will, with the £2,000,000 of First Preference already issued, *assume the position originally occupied by the Provincial Debentures of* £3,111,500." It has been repeatedly asserted by the Directors, and it is borne out by the Acts, that the Province, prior to the Act of 1856, were *first mortgagees*, and had the *first claim on the receipts of the line.* These, then, are the rights which the Preference Bondholders took when they assumed the position of the Province.

Previous to the issuing of the Report of the Directors, dated 26th October, 1860, no one doubted that the Preference Bonds, as had been always represented, and as their name implied, conferred on the holders a *first charge ;* and so late as April, 1860, subscriptions were solicited for the Second Preference Bonds, on a representation that a certain amount of gross traffic would, after deducting working expenses, leave sufficient *to pay the interest on the First and Second Preference Debentures*, showing clearly that, *at that time*, it was not supposed that *unsecured* creditors could, by obtaining judgments, interfere with the rights so repeatedly asserted to be possessed by the *secured* creditors.

In the Directors' Report of the 26th October, 1860, an announcement was, however, made, which very greatly alarmed the Preference Bondholders. It was as follows :—

"In the present embarrassed state of the Company's affairs, and the uncertainty of relief from the Government adequate to meet its liabilities, Messrs. Baring, Brothers, and Co., and Messrs. Glyn, Mills, and Co., *have obtained* a Judgment against the Company for debts due to them and others whom they represent, *which vests in their*

agents the power of seizure of the rolling stock of the road, but this measure has been adopted for the general benefit of all *present* creditors, to guard against hostile prosecution of individual claims, and for the protection of the Company's interests."

Among *present* creditors, the London Board, on being appealed to, stated they did not include the Preference Bondholders. The above announcement was the first intimation by the Directors that any legal proceedings had been taken against the Company.

In order to ascertain whether the Judgment Creditors really possessed the "*power*" which the Directors asserted in their Report, a case was laid before eminent Equity Counsel (Sir Hugh Cairns, Q.C., Mr. Amphlett, Q.C., and Mr. Westlake), accompanied by all the Canadian Acts relating to the Company, to advise thereon, and also as to the rights and remedies of the First Preference Bondholders, and the following is a copy of their opinion :—

"1. We are of opinion that by the terms of their Bonds and of the Canadian Statutes, the First Preferential Bondholders of the Grand Trunk Railway Company of Canada possess an hypothec, mortgage, charge or lien, of the same nature, covering the same kinds of property, and ranking in the same order of priority, with that which the Province had previous to the Act of 1856, st. 19 and 20 Vic., cap. 111 ; and that such charge extends to the rolling stock and plant of the Company as well as to the road and works, and is a first charge thereon.

"2. We are of opinion that the said First Preferential Bondholders are entitled, in case of any danger to their security, to have Receivers appointed, or such other means employed as by the laws of the respective jurisdictions through

which the Railway passes may be provided for protecting and making available the property included in their charge; and, assuming that there is an evident prospect of the revenue of the Company proving insufficient to pay the interest becoming due on their bonds, and that judgments to large amounts have been obtained against the Company in Upper Canada, we consider that an application to the Court of Chancery in Upper Canada for a Receiver, and an Injunction to restrain the judgment creditors from issuing execution, would be successful."

This opinion, in effect, amounts to this: that the First Preferential Bondholders are in the position of First Mortgagees on all the property of the Company, including the rolling stock, and that, consequently, no judgment against the Company can be enforced, except subject to the Preference Bondholders' prior claims.

This view of the construction of the Acts has been confirmed by the opinion of eminent Counsel both in Upper and Lower Canada.

No contrary opinion of English or Canadian Counsel has been produced; and we have reason to assume, from what has passed, that none has been obtained which can justify the claim of the Judgment Creditors to "the power of seizure of the "rolling stock."

In accordance with the opinion of Counsel, proceedings have been commenced in Canada to have the rights of the Preference Bondholders settled and determined, and also to protect the property by the appointment of a Receiver in case of attack by Judgment Creditors, and those proceedings are now going on.

Although the interest on the First Preference Bonds, which became due on the 1st January, 1861, was not met, the Directors, in their recent Report, dated 29th December, 1860, stated

that they were applying the net earnings, beyond working expenses, in meeting pressing claims for *past expenditure* in rolling stock, &c. Conceiving that they were not justified in that course, we communicated with the Solicitor to the Company on the subject, and the following is an extract from a letter received from him in reply, dated the 17th January, 1861 :—

"I am instructed by the London Directors of the Grand Trunk Company to inform you, in reply to yours of the 5th and 14th inst., that they have passed a resolution calling upon the Canadian Board to apply the earnings of the undertaking in conformity with the opinions of Sir Hugh Cairns and Mr. Lloyd, and *to remit the balance to England towards payment of the interest to the Preference Bondholders;* which course they trust will be satisfactory to your clients."

By the resolution of the London Directors referred to in this letter, they admit that the Preference Bondholders have a first charge on the net proceeds, and that the Directors are *Receivers of such net proceeds in trust, in the first place, for the Preference Bondholders.* This shuts out any dispute between the Preference Bondholders and the other classes interested in the Railway, and narrows the controversy to the question between the Preference Bondholders and the Judgment Creditors, who are outside claimants.

The interests of the Preference Bondholders and of the ordinary Bond and Shareholders are identical, in keeping the road open and developing its resources, while the necessary effect of enforcing the claim of the Judgment Creditors by seizure of the rolling stock would be to stop the road and so do irreparable damage to all classes interested, whether as Shareholders or Bondholders.

The claim of the Judgment Creditors goes to the very root of the security of the Preference Bondholders. If the *present* Judgment Creditors can seize the *present* rolling stock, then, if they were paid off, what is there to prevent fresh Judgment Creditors springing up hereafter and claiming the same rights? In this way, the *ordinary* Bonds as they become due, which they *all* do before the First Preference Bonds, might, by obtaining judgments, get what would practically be a priority over the Preference Bondholders; for nothing can be clearer than that whoever, *for the time being*, has the power of seizing the rolling stock and plant, can coerce the other classes into terms, and so get paid in preference to any one else. A large proportion of the ordinary Bonds and the whole of the Unsecured Debt have been created *since* the issue of the First Preference Bonds, and *with full notice*, therefore, of the Preference Bondholders' first charge.

The Directors, in recommending the raising of a million and-a-half sterling, in March, 1860, proposed to do so by the issue of Bonds for short periods, but "*without interfering with the existing preferential rights of the Bondholders of all classes;*" whereas, if the holders of such proposed Bonds could, as is now suggested, obtain "the power of seizure of the rolling stock" when their Bonds became due, they would practically have priority, not only over the Preferential Bonds, but over all other Bonds which became due at a date subsequent to theirs.

The Judgment Creditors having resorted to legal proceedings, the Preference Bondholders are compelled, *in self-defence*, to take steps to protect the rolling stock from seizure.

The legal contest with the Judgment Creditors cannot, it is believed, be a protracted one, as the whole question turns on the construction of the Canadian Acts. There are no disputed facts. Recent advices from Canada lead us to hope that the

Case may be brought before the Courts there for decision in a summary way, by what is called a Motion for a Decree. .

As regards the time it will take, much will depend on the character of the opposition; but remembering who are the principal Judgment Creditors, and the large interests involved, it is assumed that no difficulty will be thrown in the way of a speedy decision.

In the present embarrassed state of the Company's affairs, the Directors have applied to the Government of Canada for further aid, and we have been asked to suspend proceedings until the result of that appeal shall be known. It is of course proper that the Judgment Creditors should be paid, if the Company can raise the money without prejudicing vested rights. To facilitate that object, our Mr. Morris, on his own responsibility (and, having been recently in Canada, he had some means of forming an opinion of what was likely to be acceptable there), suggested an arrangement scheme which goes to the verge of such concession as the Preference Bondholders can be advised to make, but the Judgment Creditors are not prepared at present to entertain it.

We cannot advise the Preference Bondholders to delay proceedings on the *chance* of what the Government of Canada may do. Our Agents, in a recent letter, say (to use their own words), "the expediency of the Preference Bondholders *at once* asserting their rights ceases to be an expediency," and they give good grounds for that opinion.

The Preference Bondholders, if rightly advised, have already a first charge over everything. They, therefore, *can gain nothing* by legislation; while the Judgment Creditors, on the other hand, have *everything to gain and nothing to lose* by legislative interference. The Government of Canada are pledged to introduce *some measure* as to the Grand Trunk in the coming Session; it has been openly suggested (although we do not believe that the suggestion will or can be adopted), that the

Government should advance the two millions and a half sterling, which is said to be wanted to pay off the floating debt and provide additional rolling stock, and *take a first charge for it.*

It is a first principle of legislation not to interfere with vested rights without the consent of the parties whose interests are to be affected. We can hardly suppose that the Government of Canada would, *in any case*, depart from that principle ; still less would they do so under the special circumstances of this case.

The Act of 1856, under which the Preference Bonds were issued, was a Government measure ; it was, both in form and substance, a compact between the Province, the Company, and the Preference Bondholders, under which the money subscribed by the last-named passed *through the hands of the Government*, and was applied, under its direction, in the several works specified in the Act of 1856, which works were deemed of public and general importance to the interests of the province. The Act provided that "the proceeds of the said Bonds shall be deposited with the provincial Agents in London, and released to the Company on the certificates of the Receiver-General, upon proof, to the satisfaction of the Governor in Council, of progress of the several works hereinafter mentioned." The people of Canada have therefore had, and still enjoy, the benefit of the Preference Bondholders' money in these works.

The Government and people of Canada not only therefore cannot dispute, but are bound to support, the Preference Bondholders' claim. If the Government Act of 1856 should (although we do not admit that it does) fail to give effect to what was the admitted *intention*, the Preference Bondholders would have a right to call on the Government to remedy the defect.

It is said, however, that the Government may—without directly affecting vested rights—pass a measure providing for a

fresh grant to this Company, *on certain conditions.* The conditions which have been suggested are as follow :—1st. That all classes shall consent to a reduction in the rate of interest; 2nd. That they shall also consent to have their coupons funded for two or three years; 3rd. That the Government shall have a first charge for its proposed further advance of £2,500,000.

The Preference Bondholders could not be advised to consent to *any one* of these terms. Whether they would agree to a permanent reduction in the rate of interest in consideration of a Government guarantee is quite another question, and one which it will be sufficient to consider when such a guarantee is proposed.

The difficulty in interfering with the rights of the Preference Bondholders at all is, that *each one* has an independent charge; and no vote, therefore, of any proportion can strictly bind the whole. In *our* arrangement scheme already referred to, it was proposed to give the Canadian Government a first charge for the amount required to supply *additional* rolling stock, because—1. The scheme as a whole could be so clearly demonstrated to be to the interest of the Preference Bondholders that no objection was anticipated to this part of it; but still, 2. It was proposed that a meeting of the Preference Bondholders should be held to consider the scheme, and that if—notwithstanding the approval of the majority—one-fourth in value of the Preference Bondholders should join in dissenting, it should be negatived. By a farther part of the same scheme, it was proposed to give up, for the benefit of the judgment creditors, *any addition* which might be obtained to the present postal subsidy; but it is obvious that such concessions (if even assented to by any large proportion of the Preference Bondholders) are very different from the conditions above suggested, whereby it is proposed to raise enough to pay off the whole of the floating debt by means of a first

charge, and so give to the *unsecured* creditors a priority over the *secured;* and, further, to alter the essential nature of the Preference Bondholders' security by a reduction in the rate of interest. Neither of those objects could properly be worked out without the consent of each individual Preference Bondholder.

If the Government advance money to pay off the floating debt, they can stand in no better position than the creditors whose debts they pay.

Every attempt by legislation to interfere, directly or indirectly, with the existing rights of the Preference Bondholders, *without their consent*, will be resisted.

As to the suggested reduction of interest, let us suppose, by way of illustration, that six-sevenths in value consent, would it be fair that their decision on *such a question* should be binding on the whole? As it has been pertinently urged on us by several Preference Bondholders, if any proportion in value can bind the whole on *such a vital question*, what security can any Preference Bondholder have that he will not hereafter be still more prejudicially affected by some similar vote? Any such concession *of principle* would at once destroy the value of the Preference Bonds as a first-class security. EACH Preference Bondholder, however small in amount, has, under the Act of 1856, a charge or lien on the Railway and property of the Company for his claim. If ten persons lend £1,000 on the security of an estate, each advancing £100, and taking a separate charge for it, could it be contended, because nine out of the ten agreed to a reduction in principal or interest, that such agreement should be binding on the tenth?

No such principle would be acknowledged in England, and Canada will, we apprehend, be guided by English rules.

We have noticed the particulars of this suggested measure at some length, because it is obviously desirable that if the Government are to bring forward any measure of relief, it

should be one which can command the support of the Preference Bondholders, without whose consent no scheme *can* properly be carried out.

It has been suggested that the Government postponed their first charge on certain conditions, one of which was that the Line should be maintained and worked, and that, if those conditions be not observed, the Government lien will revive. The title of the Preference Bondholders rests upon the Act of 1856. The relinquishment by the Province of its lien in favour of the Preference Bondholders by that Act was absolute, and *not conditional.* Whether the *subsequent* postponement by the Province, by the Acts of 1857 and 1858, of its claim for interest *in favour of the ordinary Bondholders and Shareholders*, was conditional or absolute, is another question which can in no way affect the absolute and unconditional title of the Preference Bondholders under the previous Act of 1856. It is only by confounding the case of the Preference Bondholders with that of the other classes that any doubt could have been raised as to the Preference Bondholders' claim being free from any conditions.

It has likewise been suggested that the Government may come in as "salvors," treating the Grand Trunk as a "wreck," and so get a first charge for what they may advance to save it; but this is at least premature. The Grand Trunk is not yet a wreck, and, whoever else may abandon it, the Preference Bondholders do not intend to do so, as the proceedings they are now taking sufficiently indicate.

Of the 1,788 Shareholders in the recently published List, there are not more than four with an address in Canada; while recent inquiries by our Agents on the spot lead them to the conclusion that there is scarcely a single bondholder *of any class* in Canada.

The Bondholders represent nearly three times the interest of the Shareholders, reckoning the same according to the nominal value; while, at the present prices, the interest of the

Bondholders of all classes is about ten times that of the Shareholders. Yet, according to the present constitution of the Company, its *domicile* is in Canada, no legally constituted meeting of Shareholders can be held out of the province, and the Bondholders have no voice in the management.

In conclusion, and in reply to numerous inquiries, we know of no conflict likely to arise between the First and Second Preference Bondholders ; their title and interest appear to be identical, with this distinction only, that, as between themselves, the first ranks in priority to the second.

ASHURST, SON, AND MORRIS.

6, *Old Jewry, London, E.C.*
7th February, 1861.